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International Economic Policy Priorities

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Following is an address by Robert D. Hormats, Assistant Secretary for Economic and Business Affairs, before the International Insurance Advisory Council in New York on May 19, 1981.

International economic issues are increasingly important to the U.S. economy as well as to American foreign policy. Access to reasonably priced energy supplies for ourselves and our allies, for example, is an essential component of our economic well-being and our security. The financial stability of our friends and allies has a direct bearing on our prosperity and our foreign policy interests. Trade issues are central to our relations with many countries, and trade expansion is increasingly important to our economic growth. Inevitably, the Reagan Administration's domestic economic policies will affect—and will be affected by—international developments.

I would like to describe for you today some of the foreign economic policy priorities of the Administration. I will group them under five main headings.

- Strengthening the U.S. economy and improving economic cooperation with the other industrialized democracies; these together are the cornerstones of our international economic policy;
- Reducing the vulnerability of the United States and our friends and allies to disruptions in the international oil market;
- Promoting open trade on the basis of fair and effective rules and helping U.S. exporters to take advantage of international trading opportunities;
- Insuring a smoothly functioning international financial system—with an effective International Monetary Fund (IMF)—capable of facilitating recycling and adjustment and underpinning expanding trade and investment; and
- Building durable and mutually beneficial economic ties with developing nations based on a greater private sector role and supported by an effective and adequate foreign assistance program.

Strong U.S. Economy and International Cooperation

A strong American economy and close cooperation with other industrialized democracies are the cornerstones of U.S. international economic policy and our foreign policy as well. The success of the President's program to reduce inflation through increased investment and productivity growth will give this nation's competitiveness a powerful boost. It will also facilitate adjustment to high energy prices, which will lead to more efficient use of oil, and enable us better to adjust to changing market conditions, which will reduce protectionist pressures. It will lead to sustained, low-inflation growth at home, thereby improving economic prospects and lowering interest rate pressures abroad. And it will permit us to generate strong domestic support and adequate resources for our security and foreign assistance programs.

We and our industrialized country partners recognize that our economic and foreign policy prospects are inextricably linked. And while differences of approach or emphasis often receive the preponderance of public attention, the fundamental interdependence of our economies and the similarity of our international and domestic objectives make cooperation among us imperative and attempts to work at cross-purposes patently futile and unproductive.

The prosperity of our major trading and financial partners will directly influence our own. In addition, it will improve their ability to muster resources and public support for contributions to the Western security and economic assistance effort. The energy performance of these nations, like our own, will have a direct impact on the world oil market, on which we and they continue to be heavily dependent. Our mutual efforts to reduce oil imports will in turn benefit us all. A common policy toward economic relations with the Soviets can balance our commercial and our security concerns and enable us to respond decisively to such provocations as the invasion of Afghanistan. Our nations can benefit from a common, constructive approach to the developing nations, insuring that as we attempt to meet their interests, they respect ours. And we together must find new types of cooperation in research and development to bring to our societies and the world the benefits of the prodigious talents of our peoples and the potential of our technologies.

Energy Policy

The international energy situation represents the single greatest threat to the well-being of this nation, and most others, in this decade. It makes our

economies vulnerable to disruptions and our foreign policy and alliances vulnerable to threats.

Strong national and international efforts are required to reduce the unhealthy dependence of the United States and our economic partners on imported oil. We have already seen how rapid oil price rises and occasional supply interruptions play havoc with economic growth and inflation and sow discord among friends.

Due in large measure to efforts to reduce oil use in the face of sharply increasing prices and supply insecurity, U.S. imports of oil have declined dramatically to 6.3 million barrels per day (b/d) from their highs of 8.6 million b/d in 1977. But we cannot allow this progress, or the present softness in the oil market, to lull us into complacency. Much more remains to be done to reduce our vulnerability.

The President's decision to decontrol the price of domestic oil, coupled with the legislatively mandated phased deregulation of natural gas prices, are essential steps in eliciting increased production and discouraging inefficient use of energy. The Administration is also increasing its efforts to resolve regulatory and institutional problems inhibiting the use of nuclear power and will reform regulatory policies to promote greater production and use of other energy resources, particularly coal. And we will explore—in the International Energy Agency (IEA) and at the Ottawa economic summit—ways to reduce impediments to the export and use of such resources.

Yet increased production and more efficient energy use in the United States addresses only part of the energy problem. Supplies can be disrupted, as we have seen, by war and social upheaval and by national shortfalls caused by sudden demand surges. The obvious examples of these dangers stem from the Middle East; less visible is Western European dependence on the Soviet Union for substantial amounts of natural gas, which has the potential for unhealthy influence in a crisis.

We and our allies are preparing to counter threats to our energy security through intensified national action and international cooperation. Nationally, an effective strategic petroleum reserve (SPR) is crucial. I am pleased to report that we have begun to fill the SPR at an annual rate of over 200,000 b/d and hope to reach a level of 750 million barrels before the end of this decade. This could offset the loss of 3 million b/d of U.S. imports for a full year.

Internationally, the International Energy Agency is the prime forum for cooperation with other industrialized democracies. The IEA has an emergency oil allocation system, designed to counter significant shortfalls. This is the keystone of Western energy security policy. In addition, we have learned from the recent past that smaller, or even threatened, shortfalls can lead to harmful price rises. We and our colleagues in the IEA must insure that in the event of supply disruptions, such as those which followed the Iranian revolution, there is no repetition of sharp price increases, which could thwart our anti-inflation program. Nor can we permit oil to be used as an instrument of political pressure on our allies or friends. IEA consultations are underway to try to find appropriate contingency measures for these situations.

We must also develop new sources of conventional and nonconventional energy. Good relations with reliable suppliers must be maintained; and a few might be encouraged to develop additional excess capacity for use during supply interruptions. Investment climates need to be improved; discriminatory policies, such as those favoring domestic investment, can reduce optimal energy investment to everyone's detriment.

And we will continue to help developing nations to reduce their dependence on imported oil. Their inability to do so can only lead to greater instability in the developing world, and disruptions in the international financial and trading systems.

Trade

We now face challenges arising out of the success—in both foreign policy and economic terms—of the basic policies we adopted after World War II. Our goal then in establishing the General Agreement on Tariffs and Trade (GATT) and urging a more open and market-oriented trading system was to increase both world prosperity and international interdependence through the expansion of trade. World trade expanded fivefold between 1970 and 1980. By 1979 the average tariff levels in the developed countries had fallen to 10.6%. Cuts agreed to in that year, in the Tokyo Round of multilateral trade negotiations, will reduce them to 4.5%.

At the same time, a number of new problems in the trade area have become increasingly important. In order to continue into the future the expansion of trade, which has contributed so much to our prosperity and added stability to the international environment, we will have to deal with these. Our trade policy is based on several key elements:

- Effective implementation of rules already negotiated;
- Negotiating, or improving rules and understandings in new problem areas of trade policy;
- Removal of domestically imposed disincentives to U.S. exports, and improved U.S. export promotion efforts; and
- A prosperous U.S. economy which promotes adjustment.

First, we intend to insure effective implementation of the "rules of the game" already agreed to. One of the major accomplishments of the Tokyo Round was to make a start at dealing with what I consider the key trade problem of this decade—nontariff barriers. In an era of relatively low duties, these act as the major impediments to international trade. The "codes" agreed to during these negotiations are being put into effect. We will insist that our trading partners live up to the spirit and the letter of these agreements; we know that they will expect the same of us. We will use these same agreements, now embodied in U.S. law, to insure that our firms and workers are protected against unfair trade practices by other countries.

Second, we will endeavor to negotiate or improve rules to deal with new trade problems. A number of areas important to U.S. trade interests hitherto have not been the subject of much international discipline. One good example relates to trade in services.

Trade in services is an increasingly important component of U.S. exports. U.S. service exports have grown nearly 400% since 1971 and are continuing to grow at a rapid rate. Here at home, our services industries provide employment for about 70% of the U.S. workforce. Given these statistics, there is no wonder that U.S. trade representative Brock recently stated that "service trade is the frontier for expansion of U.S. exports."

At present, no coherent international framework exists for resolving trade problems in services. The Organization for Economic Cooperation and Development (OECD) in Paris has several ongoing projects to identify barriers to such trade. The United States strongly supports this work.

We will seek a political endorsement in June from OECD ministers to continue and to emphasize the ongoing work on services. In the longer term, we hope to pursue liberalized trade in services in multilateral negotiations. If we

are successful, the insurance industry will reap substantial benefits. In the interim, we will continue to utilize existing bilateral channels for resolving specific problems.

Another challenge we must meet stems from the increasingly important role of the developing countries in world trade. Our trade with the developing countries has expanded rapidly over the past decade: imports by 25% per year, exports by 18% per year, compared with a 15% increase in trade with the developed countries. The developing countries as a group are now a larger market for U.S. exports than the European Communities and Japan taken together.

Within this group, a small number of countries often referred to as the "newly industrializing countries" account for three-fourths of developing-country trade with the United States. We seek to integrate these more fully into the international trading system. This involves insuring that they undertake obligations commensurate with their stage of development. This will help insure that the poorer developing nations are treated in ways appropriate to their less advantaged positions.

In addition, we will want to insure that the international community vigorously addresses investment incentives and performance requirements, such as those which mandate local content or exports as a percentage of production, and thereby distort trade. Both developed and developing nations will also need to avoid the temptation to negotiate bilateral deals to "lock up" supplies of raw materials or energy in return for commitments of investment or market access in processed goods. These practices serve to undermine the multilateral trading system and contribute to intense international friction.

Finally, we will press hard for agreement to significantly reduce, and hopefully eliminate, the subsidy element in government export credits. The large subsidy element in the export financing of many countries is a waste of scarce resources. It is practically absurd when one considers the fact that a large portion of the benefits of this folly go to industries in Eastern Europe, which compete with us, and the subsidy is paid by the Western taxpayer.

Third, removal of export disincentives and improved U.S. export promotion efforts are necessary components of U.S. trade policy. For too long we have failed to recognize the cumulative adverse impact on U.S. exports of inhibiting U.S. regulations and laws. The trend will be reversed. In this connection, the Administration supports the export trading company bill now before the Congress, as well as legislative action to modify the Foreign Corrupt Practices Act and to reduce the income tax burden on Americans working abroad. We need also to use the resources of State, Commerce, and Agriculture Departments more effectively to promote exports. I can assure you that the Department of State and U.S. ambassadors abroad stand ready to vigorously support U.S. exporters.

Underlying a successful U.S. trade effort must be a successful domestic economic policy. Our efforts to continue the progress made so far in developing a more orderly trading system and our efforts to respond to new competitive challenges will ultimately fail unless they are backed by a vigorous U.S. economy. We often are critical of Japan's vigorous export efforts. And it is true that Japan is frequently insensitive to the impact of their exports on others and that it has not fulfilled adequately its responsibility to open its economy to others.

But we should never lose sight of the fact that Japan's rates of savings and investment, its productivity increases and its technical innovations, are, more than any other factors, the reasons for its success. Unless the United States can reverse its weakening productivity, savings, investment, and research and development picture, even the most aggressive export promotion effort will be fruitless. And the self-defeating notion will take hold that the United States cannot compete and should, instead, shelter itself from foreign competition. Improved growth, investment, and productivity performance will, on the other hand, facilitate our ability to adjust to and compete in dynamic international markets.

International Finance and Investment

In an increasingly interdependent world, the smooth operation of the financial system is as essential to world prosperity as is trade. The two proceed hand-in-hand. Two aspects of international finance have an especially important bearing on our broader economic and foreign policy interests.

Role of the IMF. The first is the central role of the IMF in the "recycling" process. The 1979–80 oil price increase has allowed the Organization of Petroleum Exporting Countries (OPEC) to build current account surpluses, which reached about $120 billion last year. The counterpart to this enormous surplus was a $50 billion deficit among the industrialized countries and a $70 billion deficit among the non-oil developing countries.

It is expected that the OPEC surplus and the industrialized countries deficit will moderate this year. The combined current account deficit of the non-oil developing countries, however, may reach $100 billion this year, and this prospect raises questions about the future financial stability of these countries. Many of these countries have not adequately adjusted their domestic economic policies to the last round of oil price increases. Essentially, they have tried to finance growth, as many did successfully during the mid-1970s, through domestic credit expansion and external borrowing.

What distinguishes the current situation from that of the mid-1970s is that interest rates are now three times what they were and debt service costs now absorb 20% of the developing countries' export earnings, up from 13% in the mid-1970s. Private financial markets have thus far been able to channel adequate funds to deficit countries and undoubtedly will continue to play the predominant role in the recycling process. And the International Monetary Fund, through access to its own resources and its influence on the judgments of the private market, has effectively supplemented this for countries attempting to adjust in order to reduce serious payments imbalances. To strengthen its efforts, the IMF is increasing its resources—in part through borrowing from OPEC—and tailoring its conditionality guidelines to current requirements.

The United States is encouraging this expansion of the IMF's role and resources. We believe it is especially well placed to encourage countries to adjust their economic policies to current international realities. And this effort will also involve OPEC countries with a very constructive form of recycling.

U.S. Investment Policy. The second aspect is U.S. investment policy. This Administration believes that market forces rather than government fiat result in the most efficient distribution of investments. This Administration will not seek to influence the decision of an investor as between investment at home and investment abroad. But when a firm has decided to invest abroad, the U.S. Government will provide maximum support: such as making available information on market prospects, facilitating contacts with appropriate officials, and supporting company efforts to resist unfair treatment. Our policy calls for insistence on national treatment for U.S. enterprises abroad—i.e., that such enterprises be treated no less favorably than local investors; and for prompt, adequate, and effective compensation in the event of expropriation.

In those countries where they exist,

we will encourage removal of unjustified impediments and disincentives to foreign investment—for example, in the tax and regulatory area. Our objective is not to force countries to accept U.S. investment, but to insure that where investments are made, they are given equitable treatment. One of our major economic goals will be to win support—by working bilaterally through bilateral investment treaties and multilaterally in the OECD and United Nations—for the goal of an open and fair investment system.

Support for Economic Development

The last area of the Administration's foreign economic policy I would like to discuss with you today is our approach to economic development. The most visible part of our policy in this area is foreign aid. You are all familiar with the grim poverty which is a fact of life in many parts of the developing world and with the traditional humanitarian concerns which have been a strong motivating element in our aid policy from the start. Our aid programs also serve other interests which have been less prominent in our public discussions of foreign assistance policy. They bolster countries of strategic importance to the United States—notably in the Middle East. They are part of our relations with countries which supply critical raw materials. The economic expansion they support reduces the likelihood of long-term social instability in certain countries and increases market opportunities for U.S. goods.

The Administration intends to insure that our policies in this area accord closely with our tangible economic and security interests in developing countries. Our aid allocations will reflect these interests as well as our humanitarian concerns. Historically, our aid has been extended both as direct bilateral assistance and through multilateral institutions. We are examining the balance between these channels, in an attempt to insure that our choice of aid tools reflects the different interests our aid programs should serve.

The overall magnitude of our aid contributions will be affected by the Administration's economic policies, and, in particular, by the drive to reduce Federal budget expenditures. Consequently, this is a good time to recall that our policies toward economic development include other elements besides aid. In fact, while aid is the most important contribution we can make to many of the poorer countries, other elements of policy play a greater role in promoting the prosperity of many other developing nations. I would single out:

- Open markets and smooth adjustment to the exports of developing countries;
- Domestic economic policies that facilitate overall growth; and
- Access to capital markets.

We have dramatically increased our imports of developing-country manufactured goods over the last decade. U.S. imports from developing countries in 1978 were nearly nine times our official aid flows. The same type of relationship holds for all the Western aid-giving nations as a group. U.S. direct investment in the developing countries runs at or above the level of aid, and private capital markets provide bank loans and bond issues in an amount which far exceeds that of development assistance.

These factors suggest that we should pay greater attention to the role of the private sector in the development process. They also suggest that a favorable climate for investment, for attracting capital flows, and for encouraging exports—without trade-distorting subsidies—will be increasingly important in this decade. The Administration, in consultation with the business community, is reviewing what we might do to facilitate private sector involvement in the development process while fully respecting its private character.

Conclusion

Let me conclude by trying to pick out a few guiding themes for U.S. foreign economic policy.

First, we need to recognize the domestic impact of international economic policy, the international impact of domestic economic policy, and the essential relationship of both to our foreign policy and security interests.

Second, the Administration believes in the efficiency of the market place and has considerable skepticism about the effectiveness of government efforts to supplant it. This belief will affect our views on the policy tools appropriate for pursuing our economic objectives.

Third, close ties between the government and the private sector are essential in helping us develop and implement our international economic policy. Likewise, close cooperation with the Congress is essential. As international economic policy becomes increasingly important to our domestic economy and to our international political and security interests, so effective cooperation among the executive branch, Congress, and the private sector become imperative in the making of that policy.

Fourth, we are persuaded that the more effective integration of the various considerations which affect economic policy is essential to our well-being, both economically and politically. Energy security, vigorous exports and open and fair trade, a world investment climate which encourages the development of productive enterprises, smoothly functioning financial markets, and the sound economic expansion of the developing countries—these are the key requirements for an improved U.S. and world economy. They also are essential contributions to world peace and fruitful political relations among countries. ■

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